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SUBJECT: TYMOSHENKO'S IMF SALVAGE OPERATION

REF: KYIV 1760

Classified By: Economic Counselor Edward Kaska for Reasons 1.4 (b) and (d)

¶1. (C) Summary. Ukrainian Prime Minister Tymoshenko dispatched Deputy Prime Minister Nemyria and Acting Finance Minister Umanskiy to Washington for meetings with IMF Managing Director Dominique Strauss-Kahn and high-level USG officials. Bearing a Letter of Intent (LOI) with three signatures -- including that of Tymoshenko, Umanskiy, and National Bank of Ukraine (NBU) governor Volodymyr Stelmakh -- Nemyria will ask the Fund on December 7 to disburse the fourth tranche, even though Ukraine has not met the IMF's conditions. President Yushchenko has refused to sign the LOI. Nemyria will likely express pessimism over the possibility of passing the 2010 budget, and he will plead for direct budgetary assistance, since the GOU has a nearly balanced current account but faces political fallout from its depleted treasury.

¶2. (C) Officials from Ukraine's Cabinet of Ministers (CabMin) described details of a December 4 phone call between Tymoshenko and Strauss-Kahn, who reportedly conditioned further IMF outlays on a signed LOI and a submitted (and passed) 2010 budget. The following day, the CabMin hailed Stelmakh's subsequent signature as a breakthrough. Embassy sources close to GOU-NBU negotiations said the NBU's acquiescence reflected Stelmakh's desire to protect his personal fortune on the eve of his retirement. End summary.

STRAUSS-KAHN ON SPEED DIAL

¶3. (SBU) A CabMin official gave the embassy a readout of Prime Minister Tymoshenko's December 4 conference call with IMF managing director Strauss-Kahn. According to the CabMin, Strauss-Kahn said that Ukraine needed to submit a LOI with three signatures. Furthermore, for the Fund to consider disbursing its fourth loan tranche of up to \$3.8 billion, the GOU would also have to re-submit and win Rada approval of the draft 2010 budget. The requirement for passage of the 2010 budget would be dropped if President Yushchenko also signed the LOI as the fourth counterparty, according to the CabMin's version of the call.

¶4. (SBU) Strauss-Kahn told Tymoshenko that he would meet with Nemyria and Umanskiy in Washington on December 7. The Ukrainian delegation also planned to meet with mission director Ceyla Pazarbasioglu and Europe director Marek Belka, before having lunch with IMF executive directors and holding talks with USG officials later in the day.

STELMAKH SIGNS THE LOI

¶5. (SBU) The CabMin reported on December 4 that Stelmakh had been increasingly "unconstructive" over the LOI upon receiving "new instructions from Bankova" (i.e. Yushchenko). Umanskiy met every day last week with senior NBU officials in an effort to convince Stelmakh to change his mind, according to the CabMin.

¶6. (C) Desperate to shore up her unfinanced budget deficit that could total at least UAH 30 billion (roughly \$3.75 billion), excluding the deficits at Naftohaz and the Pension Fund, the Prime Minister and Acting Finance Minister Ihor Umanskiy may have upped the ante after the Strauss-Kahn call. On December 5, the Cabinet of Ministers' Mariia Nikitova told us that Stelmakh had been persuaded to sign the LOI. According to Nikitova, the Prime Minister had offered Stelmakh "lots of things" to get his signature, though the exact nature of the deal remains unclear.

GOU AND NBU NEGOTIATIONS

¶7. (C) Alfa Bank executive Ivan Yurik, an advisor and close associate of former Minister of Economy Roman Shpek and former Minister of Finance Viktor Pynzenyk, confirmed that Stelmakh was operating more freely of the President. However, he believed the NBU governor's negotiations with Tymoshenko should not be construed as a betrayal of Yushchenko. Stelmakh had calculated that he could sign the LOI, knowing that Yushchenko would not be a fourth counterparty. According to Yurik, the consensus among

KYIV 00002102 002 OF 003

Ukraine's authorities had been that the IMF would not budge in its demand to have the President's signature. Thus, Stelmakh's move should be seen as a means to gain chits with the Prime Minister, while not necessarily undermining Yushchenko's hindrance of the IMF program (designed to harm Tymoshenko politically).

¶8. (C) Yushchenko may also have given Stelmakh the green light by concluding Tymoshenko hoped to perpetuate the current fiscal deadlock, as she is set to profit from a continuing resolution-type budget -- based on the bloated 2009 budget -- that would give her considerable spending discretion in 2010. The CabMin's Nikitova admitted it looked very unlikely the Rada would approve the 2010 draft, even if the GOU submitted a revised version to the Rada budget committee this week.

NEMYRIA'S STANCE IN WASHINGTON

¶9. (C) According to Nikitova, Nemyria, and Umanskiy plan to take the position with Strauss-Kahn that three LOI signatures plus a submitted (though not necessarily approved) budget should be enough for the IMF mission team to return to Kyiv. Acrimony between the Yushchenko and Tymoshenko combined with political deadlock in the Rada had conspired to prevent any further compromise or reform. The IMF should disburse the tranche to the budget, according to the CabMin's argument, to meet the January 7 payment to Gazprom and to stave off large arrears and the possibility of massive societal discord.

WORLD BANK REACTION

¶10. (C) Kyiv-based World Bank country director Martin Raiser commented on December 5 that he did not expect the IMF to further lend to Ukraine under the conditions offered by Tymoshenko. Displaying up-to-the-minute awareness of GOU-NBU negotiations, Raiser said Stelmakh's signing of the LOI was a positive -- but likely not decisive -- step. Raiser reminded that it had been because of the stalemate among Ukraine's warring politicians that the IMF left Kyiv in November

without recommending disbursement. The IMF would likely not interpret what is essentially the political status quo as rationale to roll back core IMF demands.

TYMOSHENKO NEEDS STELMAKH...

¶11. (C) In recent weeks, Tymoshenko and her close advisors had made it clear that they needed Stelmakh's support in four key areas:

- to sign the IMF Letter of Intent
- to refinance maturing GOU debt to the NBU worth UAH 4 billion (roughly \$500 million)
- to monetize new GOU debt
- to solve the stalemate over insolvent Nadra bank

The first three areas were vital for meeting fiscal obligations prior to the presidential election. The fourth area may not be as immediately pressing, though Tymoshenko has stated repaying Nadra's insured depositors was a political necessity.

¶12. (C) The Letter of Intent was Tymoshenko's top priority with the National Bank, as it had been considered necessary to unlock any further IMF disbursements. Stelmakh had already agreed to help refinance the UAH 4 billion in maturing debt, a move shadow Minister of Economy Iryna Akimova told us was politically motivated and "risky". The NBU will likely not monetize new GOU securities, arguing that it must adhere to IMF targets on base money and net international reserves.

¶13. (C) On Nadra, the government looked prepared to assume liabilities owed to insured depositors that likely total over UAH 5 billion (the exact number is unknown even to the Ministry of Finance), even though it had not determined whether the bank will be recapitalized or liquidated via a purchase and assumption transaction. Tymoshenko has long battled Yushchenko and the NBU over control of confidential documents related to Nadra shareholder Dmytro Firtash -- a Tymoshenko adversary -- and his shady financial and energy dealings.

KYIV 00002102 003 OF 003

AND STELMAKH NEEDS TYMOSHENKO

¶14. (C) Stelmakh is preparing to retire on December 16. While he will likely be appointed by Yushchenko on an interim basis through the end of the presidential term (not requiring Rada approval), Stelmakh's longer-term prospects are unclear. Multiple sources have claimed Stelmakh pilfered tens of millions of dollars, as well as looked the other way while fellow members of the NBU governing board lined their pockets with preferential bank refinancing schemes and insider currency plays.

¶15. (C) Upon his retirement, Stelmakh would not enjoy any formal immunity from prosecution, and analysts have long speculated that Stelmakh is at the top of the Prime Minister's hit list. Tymoshenko publicly called for Stelmakh's ouster in late 2008 and early 2009 over accusations that the NBU had profited from exchange rate manipulation and exorbitant refinancing deals, including with the Firtash-controlled Nadra bank.

¶16. (C) In another Tymoshenko salvo, Stelmakh's first deputy governor Anatoliy Shapovalov, also a Yushchenko loyalist, came under fire in September from Minister of Interior Yuriy Lutsenko (reftel). Lutsenko claimed top NBU leadership had "plundered millions". He also told Yushchenko, who appoints and dismisses the NBU governor, "to prepare his subordinates for jail".

¶17. (C) Former NBU deputy governor Oleksandr Savchenko, a Tymoshenko associate who resigned during the "Shapovalov affair", claimed his former NBU colleagues had conspired in currency speculation. Now Deputy Finance Minister, Savchenko told a closed door group of diplomats, IFI representatives, and fellow high-level Ukrainian authorities on December 3 that NBU authorities had "only perpetuated the crisis" by sins of omission and commission.

¶18. (C) Alfa Bank's Ivan Yurik believes the Tymoshenko-Stelmakh relationship had become temporarily co-dependent. Yurik said Tymoshenko had plenty of information to prosecute and convict Stelmakh. While Yushchenko's power to protect Stelmakh was receding, the possibility of a Tymoshenko presidency could not be discounted, and Stelmakh had determined that he must secure his ill-gotten gains. Tymoshenko stood in the way of a comfortable retirement and a secure "pension".

NBU ORCHESTRATIONS

¶19. (C) On December 4, NBU deputy director for banking supervision Ruslan Gritsenko insinuated to Econoff and IMF advisor Engin Akcakoca that NBU senior management had been engaged in heightened corruption in recent days. Gritsenko said NBU officials knew "perfectly well" about current arrangements between bank managers and regulators over refinancing and recapitalization schemes. The NBU governing board had "profitable" ties with Ukrainian banks and firms and did not see a need to reach out to foreign bankers who had been complaining about NBU non-transparency. The NBU's Gritsenko did not comment explicitly about Stelmakh's plans after his scheduled December 16 retirement, but said "this was being worked out".

COMMENT

¶20. (C) Stelmakh does not have his own independent power base and will soon be out of office. While his signature carries the weight of his title, it does not necessarily reflect NBU concurrence on budgetary and exchange rate policy. Neither does it serve as a signal of unquestioned support for an IMF program that would plug Tymoshenko's budget gap in favor of bolstering the NBU's foreign reserves. Stelmakh has walked a fine line in his negotiations with two masters: tied to Yushchenko politically and personally, he has much to lose by unleashing the Prime Minister's enmity. Along with his agreement to refinance UAH 4 billion of GOU debt, Stelmakh's decision to sign the LOI, leading to today's negotiations with the IMF, should be understood as the least risky of all his possible moves.

TEFFT